

Message Text

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PAGE 01 SEOUL 01494 280603Z

15

ACTION EB-07

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E.O. 11652: N/A

TAGS: EWWT EFIN KS US

SUBJECT: KOREAN DEFENSE TAX

REF: STATE 44437, SEOUL 1432, STATE 47105, SEOUL 1457

SUMMARY: EMBOFFS ADVISED OFFICIAL OF MINISTRY OF FINANCE (MOF) OF PROBABLE ADVERSE IRS INTERPRETATION OF IMPOSITION OF KOREAN DEFENSE TAX ON U.S. SHIPPING FIRMS AND AIRLINES. MOF OFFICIAL SAID THAT HIS GOVERNMENT DID NOT CONSTRUE DEFENSE TAX AS TAX ON INCOME AND THUS DID NOT BELIEVE BASIS FOR RECIPROCITY WAS UNDERMINED. HE REITERATED MOFA VIEW THAT FIRMS IN QUESTION WOULD BE EXEMPTED FROM DEFENSE TAX BY PENDING US-KOREAN TAX CONVENTION. HE SAID MOF WOULD FURTHER STUDY QUESTION OF DEFENSE TAX APPLICABILITY. END SUMMARY.

1. AS INSTRUCTED SECOND REFERENCE EMBOFFS ADVISED CHO JOONG-HYUNG, INTERNATIONAL TAX AFFAIRS OFFICER OF THE MINISTRY OF FINANCE (MOF) OF PROBABILITY OF ADVERSE IRS INTERPRETATION OF IMPOSITION OF KOREAN DEFENSE TAX ON U.S. SHIPPING FIRMS AND AIRLINES. CHO RESPONDED THAT WHILE THE DEFENSE TAX WAS IMPOSED ON NET INCOME THE KOREAN GOVERNMENT VIEWED IT AS A SURTAX AND NOT AS A TAX ON INCOME PER SE AND THAT EVEN THOUGH HE COULD UNDERSTAND HOW THE IRS COULD ARRIVE AT ITS INTERPRETATION HE DID NOT FEEL THAT THE DEFENSE TAX SHOULD COME WITHIN THE PUR-

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PAGE 02 SEOUL 01494 280603Z

VIEW OF SECTION 883 OF THE INTERNAL REVENUE CODE.

2. CHO MAINTAINED THAT SINCE U.S. SHIPPING AND AIR TRANSPORT COMPANIES WILL CONTINUE TO BE EXEMPTED FROM CORPORATION AND BUSINESS TAXES IT WAS THE MOF OPINION THAT THE BASIS FOR RECIPROCITY STILL EXISTED, BUT THAT MOF WILL LOOK INTO THE MATTER FURTHER. HE STATED THAT KOREA HAD GRANTED RECIPROCITY TO U.S. FIRMS EVEN THOUGH IT WAS HIS UNDERSTANDING THAT KOREAN SHIPPING AND AIR TRANSPORT FIRMS WERE SUBJECT TO U.S. STATE INCOME TAXES.

3. IN FURTHER DISCUSSION EMBOFF EXPLORED ON INFORMAL BASIS WITH CHO POSSIBLE APPLICABILITY OF KOREAN-U.S. FCN TREATY IN FORCE. EMBOFF ASKED IF CHO THOUGHT ARTICLE XI (PARAGRAPH 3, ON MOST-FAVORED-NATION TREATMENT IN RESPECT TO TAXES) COULD APPLY, SINCE WE UNDERSTOOD THAT JAPANESE SHIPPING AND AIR TRANSPORT COMPANIES WERE EXEMPT FROM THE DEFENSE TAX. CHO CONFIRMED THE EXEMPTION OF SUCH JAPANESE COMPANIES AND OFFERED HIS PERSONAL OPINION THAT IT WOULD BE WORTHWHILE FOR US TO PURSUE THE QUESTION FURTHER WITH THE MINISTRY OF FOREIGN AFFAIRS. HE SAID THAT HE WAS AWARE, HOWEVER, OF AT LEAST ONE CASE WHERE THE KOREAN GOVERNMENT HAS HAD DIFFICULTY IN OBTAINING A FAVORABLE U.S. INTERPRETATION OF THE MFN PROVISION OF THE FCN TREATY. FOR SEVERAL YEARS THE KOREAN GOVERNMENT HAS BEEN SEEKING WITHOUT SUCCESS TO HAVE KOREAN TEMPORARY WORKERS ON GUAM RELIEVED OF FICA TAXES ON THE BASIS OF A PROVISION OF THE INTERNAL REVENUE SERVICE CODE WHICH EXEMPTS PHILIPINO WORKERS FROM SUCH TAXES.

4. CHO SAID THAT MOF INTERPRETED THE PENDING U.S.-KOREA TAX CONVENTION TO MEAN THAT UPON ITS ENTRY INTO FORCE U.S. SHIPPING AND AIR TRANSPORT COMPANIES WOULD BE EXEMPT FROM THE DEFENSE TAX SINCE ARTICLE TEN EXEMPTS "INCOME." (THE CORRESPONDING WORDING IN THE JAPAN-KOREA TAX CONVENTION IN FORCE IS SIMILAR TO ARTICLE TEN OF THE DRAFT U.S.-KOREA CONVENTION. THE JAPAN CONVENTION PROVIDES "INCOME OR REVENUE" WHICH DERIVES FROM THE OPERATION IN INTERNATIONAL TRAFFIC OF SHIPS OR AIRCRAFT SHALL BE EXEMPT FROM TAX IN THE OTHER CONTRACTING STATE).
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